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SMS, the most expensive yet also the most used data application

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Contemporary wisdom says that the lower the price of a service, the more people will use it. Consumer electronics is a great example of this – while the early adopters will pay a premium to be the first to own a new gadget, it is only when the price drops that mass adoption takes place.

Consider this then. SMS is undoubtedly the most popular data channel in the world, with 4.16 billion SMS users, compared to 2 billion internet users across all devices, at the end of last year. These texters sent 6.1 trillion messages in 2010, up from 1.8 trillion in 2007.

Now consider that an average SMS contains 140 bytes of information: 160 7 bit characters excluding headers. Sending a local SMS in South Africa will cost you around 75 cents, depending on your service provider. This equates to a massive R 5 357 per megabyte.

SMS volumes show no signs of slowing down, despite the inflated SMS prices. Indeed, operators have very little incentive to drop SMS rates – not out of greed, but based on consumer behaviour and commercial reality. SMS usage from clients will not increase significantly when prices are lowered. In addition, dropping SMS prices will not increase the market share of an operator significantly.

Why is this?

What drives consumer choice?

Firstly, few consumers choose an operator, and likewise choose to leave an operator, because of its SMS pricing. The main reasons for choosing an operator according to an Accenture report are:

1. Getting the latest and greatest handset - which is why operators will subsidise a handset in return for a two-year commitment.
2. The total cost of the contract, and as SMS makes up less than 10% of that cost, the subscription cost and voice call costs are much higher priorities for consumers.
3. Service level and customer care quality.

SMS is simply not a major influence, hence there is no reason for operators to use SMS pricing to attract and retain customers.

Inelastic pricing

Secondly, SMS pricing is not elastic. This means that if the price drops, customers won't send that many more SMSs and if the price rises, SMS volumes do not reduce much. This is similar to the petrol price: even if the price rises, consumers use their cars more or less at the same level out of necessity – they have to get to work, drop the kids at school and so on.

Compare this to internet bandwidth, which is very price elastic, and a drop in price results in a massive increase in usage by customers. Most South Africans found a whole lot of new uses for their bandwidth that they hadn't considered previously when uncapped internet packages entered the market.

So from an operator's point of view, dropping the price of SMS will not be balanced out by an increase in volumes or increase in market share, as it is when bandwidth prices are dropped.

According to a Management Science Report, *An Empirical Analysis of Mobile Voice Service and SMS: A Structural Model*, the elasticity of voice calls is -0.08, which means that if the price of voice calls increases by 10%, the volume of voice calls would go down by 0.8%. SMS has an elasticity of -0.03, so if the price of SMS goes up by 10%, the volume of messages would only go down by 0.3%.

The relatively low elasticity of both voice and SMS, indicates that consumers regard both services as indispensable, giving operators no reason to drop rates.

Voice and SMS

Things get even more interesting when you start looking at the relationship between voice and SMS.

If the price of SMS, for instance, drops, people will make fewer voice calls in favour of the now cheaper SMS, and vice versa. While this effect of cross price elasticity is small, it further reduces the incentive for network operators to lower SMS prices as it would simply eat into their voice volumes.

Different rates

So why then is there a difference between the price charged for SMSs by the operators? The smaller operators charge far less to send an SMS:

Operator	Peak rate for an SMS
Vodacom	80c
MTN	75c
Virgin Mobile	60c
Cell C	50c
8ta	50c

Note that for some operators, off-peak rates are much lower. Mobile packages sometimes include a number of free SMS messages in the subscription cost, SMS bundles can be purchased at discount prices, and specialised packages offer SMS as low as 20c per message.

The smaller networks are hoping to increase usage and increase market share with their lower pricing. The larger operators are not following suit as with current consumer behavior, their market share and SMS usage is unlikely to change much. This results in higher profitability, which is spent on areas which they know consumers desire (such as increasing handset subsidies).

Should consumer behaviour change, network strategies will follow suit. Consumers can already spend significantly less on SMS messaging regardless of which network they are on, by simply selecting a different package (with lower SMS pricing or more free messages included) or buying SMS bundles. Virgin Mobile for



instance offers 1,000 free SMSs with some packages.

But while Virgin Mobile subscribers benefit from cheaper SMS rates, the receivers of the SMSs are not always that happy. Already, people are complaining that their Virgin Mobile contacts are sending them too many SMS messages. It seems that for many, SMS is a great communications tool, provided they don't receive too many messages.

Limiting SMS overload

Some operators have identified an opportunity to limit communications overload for their customers, and instead of lowering SMS prices, they reward subscribers for receiving SMS messages. This is only possible in countries where local interworking SMS fees are charged such as Italy. The operators pass on the interconnect fee they earn for delivering the message, to the subscriber.

Around the world, SMS prices have remained much the same for the last 10 years. Indeed, some operators, notably in the USA, have actually increased SMS prices. This is unheard of in the ICT industry, where costs have been plummeting for the last decade. So the humble SMS, which started commercial life by accident, bucks the trend once again.